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Counting the Change: Accounting for the Fiscal Impacts of Controlling Carbon Emissions

On November 1, 2007, the House Budget Committee held a hearing titled “Counting the Change: Accounting for the Fiscal Impacts of Controlling Carbon Emissions.” The purpose of the hearing was to explore the fiscal and distributional impacts of limiting greenhouse gas emissions. Below are some highlights from the hearing.

Witnesses testified that global climate change will have serious effects—Witnesses testified that the atmospheric concentrations of greenhouse gases, particularly carbon dioxide, have gradually increased over the past century and are contributing to the warming of Earth’s climate. In light of the scientific evidence about the potential damages this could cause, momentum is growing to impose mandatory limits to stabilize and eventually reduce U.S. emissions of greenhouse gases.

Taking action now to mitigate greenhouse gas emissions would produce social benefits exceeding costs, according to the Congressional Budget Office (CBO)—While it is difficult to assign a quantitative value to the benefits of climate change mitigation, CBO testified that “most analyses suggest that a carefully designed program to begin lowering carbon dioxide (CO₂) emissions would produce greater benefits than costs.” This hearing examined ways to minimize the cost of climate change policy, *apart* from the benefits that would be derived from pursuing the policy in the first place.

CBO values carbon market in the billions—One of the most prominent methods of reducing greenhouse gas emissions involves a “cap-and-trade” mechanism. Under this system, the total level of CO₂ emissions would be capped and corresponding emissions allowances would be issued. According to CBO, “the annual value of emissions allowances would be roughly \$50 billion to \$300 billion by 2020.”

According to CBO, under a cap-and-trade system, giving allowances away for free would generate windfall profits for private industry and shareholders—According to CBO’s review of the evidence, less than 15 percent of the total value of the allowances would be needed to compensate for the net financial losses of companies affected by the policies to restrict emissions. CBO cites one study that examined the impacts of a 23 percent reduction in emissions. Under this scenario, if all of the allowances were distributed for free to energy producers, stock values would double for oil and gas companies and increase more than sevenfold for coal producers.

Giving emission allowances away will not solve issue of energy prices, according to testimony—Witnesses testified that it is a common misperception that giving away the allowances to affected companies will mitigate against energy price increases. The law of supply and demand means that energy prices would be expected to rise whether energy companies have to buy allowances or are given them for free. A cap on emissions will limit the amount of energy produced from fossil fuels. Regardless of whether the government gives away or sells the allowances, witnesses testified that market forces would be expected to raise the price of fossil fuel energy.

Witnesses testified that government’s capture of the carbon market’s proceeds can be used to mitigate economic impacts—If allowances are sold, such as through an auction, the government would capture significant resources that could then be used to buffer the negative impacts of carbon trading systems for certain sectors, regions, and households.

Climate change control policies could disproportionately affect low-income households—The Center for Budget and Policy Priorities (CBPP) estimates that the average increase in energy-related costs for the poorest fifth of the population could amount to \$670 to \$950 per year (from a modest 15% emissions reduction). “Households with limited incomes will be affected the most by those higher prices, since they spend a larger share of their incomes on energy-related products and services than more affluent households do,” said Bob Greenstein, Executive Director of CBPP.

14 percent of auction proceeds would fully offset the increased costs to impoverished families, according to CBPP—CBPP estimates that the impact of carbon controls on the poorest 20 percent of the population could be fully offset by using just 14 percent of the total resources. According to CBPP, use of existing mechanisms such as electronic benefit transfers and increases in the Low Income Home Energy Assistance Program would be the most effective way of reaching large numbers of low-income households.

Carbon tax vs. cap-and-trade—Carbon taxes represent another option to control greenhouse gas emissions. While CBO pointed out that “a tax is generally the more efficient approach,” CBO Director Peter Orszag (along with other panelists) suggested that there are ways of enhancing the economic efficiency of a cap-and-trade program to provide flexibility and minimize price spikes.

Federal cap-and-trade system may be reflected in the budgetary scoring process—CBO indicated that “there is a solid case to be made that even allowances that were given away by the government should be reflected in the budgetary scoring process—specifically that the value of any allowances initially distributed at no cost to the recipients should be scored as both revenues and outlays, with no net effect on the budget deficit.”